

## ANALYSIS OF ORIGINAL BILL

Author Ridley-Thomas

Analyst: Gail Hall

Bill Number:

AB 2547

Related Bills: See Legislative History

Telephone: 845-6111

Introduced Date: February 23, 2006

Attorney: Patrick Kusiak

Sponsor:

**SUBJECT:** Interest Deduction For Financial Corporations On Loans Granted For Redeveloping Brownfields Located In Blighted Areas

### SUMMARY

This bill would allow a deduction for certain corporations as specified.

### PURPOSE OF THE BILL

The author's staff has indicated that the purpose of the bill is to provide an incentive to financial corporations to loan money for the purpose of improving economically depressed areas.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and would apply to taxable years beginning on or after January 1, 2006.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Federal law defines a "financial corporation" as a corporation that derives at least 80% of its gross income from financial services, such as banking, financing, or similar business. Interest earned by a financial corporation is included in gross income and subject to federal tax.

Current state law defines a "financial corporation" as a corporation that derives over 50 percent of its total gross income from transactions attributable to money or moneyed capital.<sup>1</sup> "Money or moneyed capital" includes, but is not limited to, coin, cash, currency, mortgages, deeds of trust, conditional sales contracts, loans, commercial paper, installment notes, credit cards, and accounts receivable.<sup>2</sup> Interest earned by a financial corporation on these transactions is included in gross income and subject to tax.

<sup>1</sup> Cal. Code Regs., tit. 18, Section 23183(a).

<sup>2</sup> Cal. Code Regs., tit. 18, Section 23183(b)(3).

Board Position:

☐ S      ☐ NA      ☐ NP  
☐ SA      ☐ O      ☐ NAR  
☐ N      ☐ OUA      ☒ PENDING

Department Director

Date

Selvi Stanislaus

4/24/06

A "brownfield" is defined in the Health and Safety Code as property that meets all of the following conditions:

1. Is located in an urban area,
2. Was previously the site of economic activity that is no longer in operation at that location, and
3. Has been vacant or has had no occupant engaged in an economically productive activity for a period of not less than the 12 months previous to the date of application for a loan.

A brownfield does not include any of the following:

1. Property listed, or proposed for listing, on the National Priorities List, a list that prioritizes hazardous sites for investigation by the Environmental Protection Agency,
2. Property that is, or was, owned or operated by a department, agency, or instrumentality of the United States, or
3. Property that will be the site of a contiguous expansion or improvement of an operating industrial or commercial facility, unless the property is a brownfield.

The term "blighted area" is defined in the California Health and Safety Code and generally includes areas that have physical and economic disadvantages requiring redevelopment in the interest of health, safety, and general welfare of the people of these communities and of the state.

A "blighted area" is one that contains both of the following:

1. An area that is predominantly urbanized and is an area in which the combination of physical conditions caused by blight is so prevalent and so substantial that it causes a reduction of, or lack of, proper utilization of the area to such an extent that it constitutes a serious physical and economic burden on the community, which cannot reasonably be expected to be reversed or alleviated by private enterprise or governmental action, or both, without redevelopment.
2. An area that is characterized as having one or more physical or economic conditions of blight. A blighted area may also be characterized by the existence of inadequate public improvements, parking facilities, or utilities.

Examples of blight are:

1. Unsafe or unhealthy buildings for persons to live or work,
2. Faulty lot layout in relations to size, adequacy, accessibility, or usefulness,
3. Unsafe or unsanitary conditions,
4. High vacancy rates for residential or commercial property as compared to other areas,
5. Incidence of crime in the area is high as compared to other areas, and
6. Deterioration of site or other improvements.

### THIS BILL

This bill would allow financial corporations a deduction for the amount of net interest received on loans made for purposes of redeveloping brownfields that are located in blighted areas. A deduction shall be allowed if each of the following requirements is met:

1. The redevelopment occurs solely within the brownfield,
2. The indebtedness incurs solely in connection with the redevelopment,
3. The financial corporation has no equity or other ownership interest in the debtor, and
4. The financial corporation and debtor are not members of a commonly controlled group<sup>3</sup>.

## **IMPLEMENTATION CONSIDERATIONS**

This bill would not significantly impact the department's programs or operations.

## **TECHNICAL CONSIDERATIONS**

The department has identified the following technical considerations. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. The author should consider defining "net interest" as this term could be interpreted inconsistently by taxpayers and the department.
2. The author should consider adding language granting the Franchise Tax Board authority to prescribe rules and regulations to carry out the provisions of the bill and clarify any unforeseen issues that may arise.

## **LEGISLATIVE HISTORY**

AB 912 (Ridley-Thomas, 2005/2006) would have allowed financial corporations, incorporated in California, to exclude any amount of interest income received on loans made for purposes of redeveloping brownfields located in blighted areas. The language in AB 912 as introduced was amended out of the bill and replaced with Hurricane Katrina legislation.

## **OTHER STATES' INFORMATION**

The states surveyed included *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Although these states do have some tax incentives relating to physical and economically depressed areas, they lack specific laws similar to this bill.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Revenue Estimate

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<sup>3</sup> R&TC Section 25105.

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 2547 As Introduced 2/23/06 [\$ In Millions]			
Assumed Level of Net Interest Deduction	2006-07	2007-08	2008-09
\$10 Million	a/	-\$1.0	-\$1.0
\$25 Million	-\$1.0	-\$2.5	-\$2.5
\$100 Million	-\$4.0	-\$10.0	-\$10.0
a/ Loss of less than \$500,000.			

### Revenue Discussion

The revenue impact of the bill would be determined by the amount of interest deducted from income by financial corporations and the tax rate of corporations making such loans for redeveloping brownfields located in blighted areas.

California has an estimated 100,000 brownfield sites, the majority of which are located in urban areas and downtown communities. Brownfields are tracts of land that were once used as industrial sites. Brownfields are properties that are contaminated, or thought to be contaminated, and are underutilized due to perceived remediation costs and liability concerns. Most brownfields are located in blighted areas. There are roughly 600 taxable financial corporations filing returns in California. It is not known what the level of qualifying loans is currently, or what new loans may be made if this bill is enacted. Accordingly, for purposes of an estimate, three possible net interest deduction amounts are assumed: \$10 million, \$25 million, and \$100 million. These interest amounts are multiplied by an average apportionment factor (if applicable), and a financial tax rate of 10.84 percent to derive the potential tax revenue loss. Revenue effects in the initial year are assumed at 40 percent of a full-year effect.

### **POLICY CONCERNS**

Federal law prohibits discriminatory state taxation of interest on federal obligations such as interest received from a U.S. Treasury Bill. This bill provides a deduction to financial corporations for interest earned on certain loans. This bill could be interpreted as discriminatory because all interest earned on a federal obligation (e.g. a Treasury bill) is subject to California's franchise tax but only a part of the interest that would be earned from a loan made for redeveloping a brownfield would be subject to the California franchise tax.

### **LEGISLATIVE STAFF CONTACT**

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